Number of Exec Chairs Grows, but Pay Drops
By Amanda Gerut October 13, 2014

Pay for executive chairs is beginning a slow decline, while the number of former CEOs settling into the executive chairman role after they leave the corner office is increasing.

According to forthcoming data from compensation consulting firm Hay Group, median pay for executive chairmen fell from $3.36 million in 2011 to $1.98 million in 2013 among the 300 largest companies.

During the same period, the executive chairman's total annual compensation as a percentage of the CEO's total annual compensation also declined from 95.7% to 68.4% at the median.

Irv Becker, national practice leader at Hay Group, says even though executive chair pay varies widely from company to company depending on the role and responsibility of the individual executive chair, he's not surprised to see the medians coming down.

"Boards are trying to get to a place where the executive chairman is further away from the CEO role than maybe they were a few years ago," explains Becker.

Often, the executive chairman role is filled by a departing CEO and in the past was seen almost as a continuation of some of the responsibilities the CEO previously held.

Now, however, boards see the executive chairman role as a way to transition to a new CEO without also weighing down the new executive with a board chairman role. At the same time, the board can retain the steady hand of the outgoing executive. But the outgoing executive is now viewed mainly as a board member with company responsibilities rather than as the former CEO with holdover executive responsibilities.

The difference is subtle, but shows an evolution in the way boards view their governance structure, Becker says.

"The idea here is that the executive chairman role is not as close to the CEO [role] as maybe we were thinking a few years ago, and is closer to a board member," says Becker. "And as such, the compensation will likely continue to come down."

At the same time that pay for executive chairs has begun to decrease, the prevalence of executive chairs has risen.

Hay Group regularly analyzes data from the 300 largest companies. In its sample, the presence of executive chairmen on boards grew from 10.7% in 2011 to 13% in 2013.

Spencer Stuart's S&P 500 data shows a similar trend. Among companies that underwent a CEO transition in 2013, 45% of outgoing CEOs stayed on as board chair. The year before, just under a third of outgoing CEOs remained to chair the board.

Dennis Carey, vice chairman at Korn/Ferry International, points out that some companies find it very convenient to pass the baton to an internal candidate who hasn't been a CEO before while pairing them up with an executive chairman who has had a successful run at the company.

At Tyco International, a client of Carey's, Ed Breen took on the CEO role following a crisis that nearly ruined the company. Breen shepherded Tyco through a turnaround and served successfully for a decade. He then stayed on as executive chairman when George Oliver took the CEO job in 2012.

"George had never been a CEO before, but the board felt comfortable bringing George up to the CEO title under the assumption that Ed would stay on as executive chairman," Carey says. "That example typifies most of these situations where CEOs have been successful and very respected on the Street and in the boardroom."

In addition, sometimes boards opt to trigger a CEO change on a less-than-optimal timetable for the outgoing CEO, explains Andrew Goldstein, who leads Towers Watson's executive compensation practice in the central region of the United States. If there's a business change or the CEO heir apparent is being recruited to another company, the board may decide to speed up their timing. If the outgoing CEO has valuable compensation or retirement benefits that haven't yet vested, moving the CEO into an executive chairman position can make way for a CEO transition and allow for accelerated timing on unvested compensation.

"The executive chair position is useful from a number of different perspectives in terms of facilitating a leadership transition," says Goldstein.

Typically, the executive chairman is there for about a year, but some terms run for significantly longer.

Carey agrees that the former-CEO-turned-executive-chairman phenomenon is growing, but cautions that this isn't a trend that boards should be prompted to follow unless the situation calls for it. He also suggests that the new and former CEOs sit down and map out their respective roles to avoid running into each other on the operating side or taking opposite views on the same issue, for example.

"Those two have to be singing from the same hymn sheet to make sure there's no apparent conflict between the two of them," says Carey.

And while the board and CEO have to agree on precisely how the executive chairman will work with the CEO and the board, pay for executive chairmen is all over the map.

How to Pay an Executive Chair

Jan Koors, managing director and head of the Chicago office at Pearl Meyer & Partners, says pay for executive chairs is typically determined after factoring in the role the executive played before becoming the executive chair, and whether the role is a permanent one or a vehicle for a CEO transition.

"Not only the history of the person but what the expectations are for the short-term future role of that person can impact what that executive chair's compensation looks like," says Koors. "That accounts for the wide variety of structures."

For example, if the executive chair role is a permanent position at the company or one that might last for multiple years, it's likely that the executive chair will participate in both short- and long-term incentives and earn variable pay based on the achievement of certain company goals and objectives.

On the other hand, says Koors, if the role is a stepping-stone so the company can transition to a new CEO, it's more likely the board will shift the executive chair away from incentives because they'll be expected to provide more oversight of the management team.

In addition, Becker of the Hay Group says he has begun to see boards take a greater interest in making sure former CEOs, who are still connected to the company, maintain a vested interest in the success of their successor. Boards are accomplishing this by allowing former CEOs' equity to continue to vest for a few more years after they leave the CEO role and continued participation in performance-based equity.

"Some boards take the view that the primary responsibility of the [departing] CEO is to ensure a good transition, and he or she should have a vested interest in the success of his or her successor," says Becker. "I think it's a good practice and I think more and more companies are adopting it."

For example, former Teradyne CEO Michael Bradley's unvested restricted stock units and stock options will continue to vest through January 2017, the company disclosed. Bradley retired from the CEO position effective January 31, 2014, and now serves on the board.

Similarly, former Franklin Electric Co. CEO Scott Trumbull, who is now the non-executive chairman of the company's board, is participating in the company's annual bonus program for 2014, with a target bonus opportunity of $592,500, the company disclosed. The bonus will be based on 2014 financial goals.